Ministry of the Economy

Saskatchewan Oil and Gas Orphan Fund Annual Report for 2016-17

saskatchewan.ca

Government of Saskatchewan

Table of Contents

Letters of Transmittal 1

Management's Responsibility for Financial Statements 3

Introduction 4

Program Purpose 4

Program Activities 4

Oil and Gas Orphan Fund Financial Statements 7

Auditor's Report 8

Statement 1 9

Statement 2 10

Notes to Financial Statements 11

Letters of Transmittal

Her Honour, the Honourable Vaughn Solomon Schofield
Lieutenant Governor of Saskatchewan

May it Please Your Honour:

I respectfully submit the Annual Report of the Saskatchewan Oil and Gas Orphan Fund for the fiscal year ending March 31, 2017.

The Honourable Dustin Duncan
Minister of Energy and Resources

The Honourable Dustin Duncan
Minister of Energy and Resources

Dear Minister:

I have the honour of submitting the Annual Report of the Saskatchewan Oil and Gas Orphan Fund for the fiscal year ending March 31, 2017.

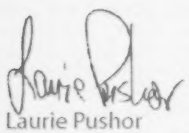
Laurie Pushor
Deputy Minister of the Economy

Management's Responsibility for Financial Statements

The accompanying financial statements included in the annual report of the Oil and Gas Orphan Fund for the year ended March 31, 2017, are the responsibility of the management of the Ministry of the Economy. Management has prepared the financial statements in accordance with Canadian public sector accounting standards. The financial information presented elsewhere in the annual report is consistent with that in the financial statements.

To ensure the integrity and objectivity of the financial data, management maintains a comprehensive system of internal controls including written policies and procedures, and an organizational structure that segregates duties. These measures provide reasonable assurance that transactions are recorded and executed in compliance with legislation and required authority, that assets are properly safeguarded, and that reliable financial records are maintained.

The financial statements have been audited by the Office of the Provincial Auditor. Its report to the Members of the Legislative Assembly stating the scope of its examination and opinion on the financial statements appears on page 7.



Laurie Pushor
Deputy Minister of the Economy
Regina, Saskatchewan

Introduction

The Saskatchewan Oil and Gas Orphan Fund was established in legislation in June 2007, following extensive consultation with oil and gas industry associations and other stakeholders. The consultative process led to the development of a comprehensive and robust set of regulations and a program that is fully funded and supported by the oil and gas industry.

The Oil and Gas Orphan Fund provides funding to address the costs of abandoning and decommissioning orphan wells and facilities and reclaiming the sites, as well as the costs of containing environmental emergencies arising from oil and gas operations. The fund receives revenue primarily through an annual levy that is paid by the oil and gas industry, thereby protecting taxpayers from exposure to these industry liabilities.

The legislative authority and specific provisions of the fund are found in The Oil and Gas Conservation Act and the regulations thereunder.

The fund is administered by the Saskatchewan Ministry of the Economy.

Program Purpose

An orphan oil well is one in which the company that was the licensee or owner of the well has ceased to exist due to insolvency or bankruptcy. The costs associated with proper abandonment, decommissioning and reclamation of these orphaned wells and facilities and the environmental liability associated with the sites are significant.

The Saskatchewan Oil and Gas Orphan Fund was established as a means through which industry pays for the costs associated with orphan wells and facilities, thereby ensuring these costs do not get passed on to Saskatchewan taxpayers.

The total forecasted cost to the orphan fund was estimated in March 2017 to be approximately $56 million.

The program is also designed to reduce long-term costs through the Licensee Liability Rating (LLR) system. Each oil and gas company operating in Saskatchewan is rated numerically using the LLR system, and as a general statement, the higher a company's rating, the less risk it poses. Generally, those companies whose rating is greater than 1.0 are considered to be in good standing, while those with a rating of less than 1.0 are required to submit a security deposit to offset the risk they pose to the orphan fund.

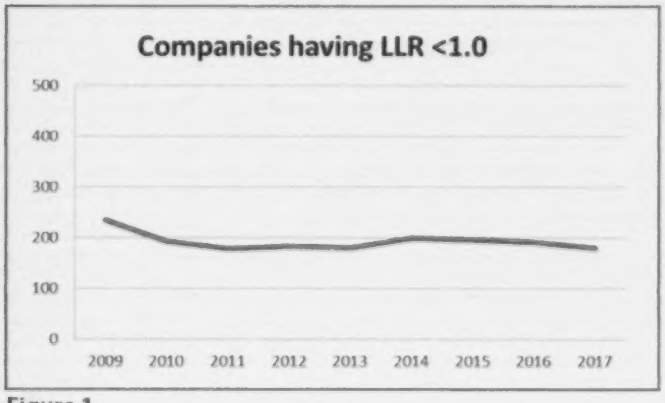


Figure 1

Tracking the number of companies operating with an LLR less than 1.0 over time can provide insight into the risk that wells will be orphaned in the future. Figure 1 shows that this has been relatively stable (at approximately 200) since the inception of the program. The number of companies in the category collectively represents about 6 per cent of total provincial oil and gas liabilities and about 1.2 per cent of total provincial production value.

The number of companies having an LLR greater than or equal to 1.0 has steadily declined over the same period, from 293 to 144. The decline is a combination of smaller companies forming into larger ones and companies whose LLR fell below 1.0 when they were previously above 1.0. The companies having an LLR greater than or equal to 1.0 represent approximately 94 per cent of total provincial oil and gas liabilities and about 98.8 per cent of total provincial production value.

Figure 2 shows that the average provincial LLR has steadily declined since the inception of the program, which indicates that total industry liability is increasing more rapidly than total industry asset value. While the number of active wells is increasing, so is the

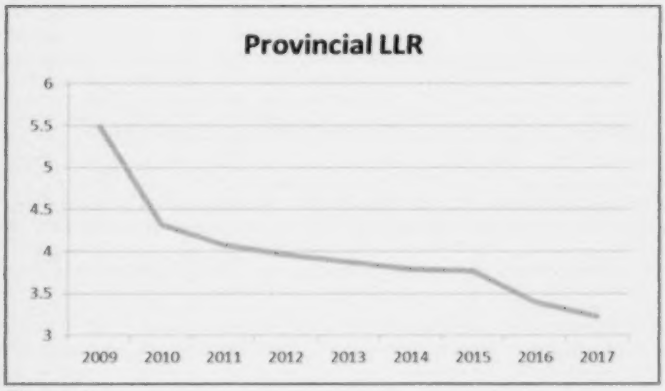


Figure 2

number of mature wells reaching the end of their economic life, adding additional liability to the system over time.

Taken together, Figures 1 and 2 indicate that the forecasted number of companies required to submit security may increase with time and that future numbers of orphan wells may rise over time. This underscores the value and the effectiveness of the program.

In order to manage the financial risks into the future, the Ministry must ensure that unfunded industry liabilities are offset with security. Figure 3 below shows that industry's unfunded liability prior to the beginning of the orphan program was approximately $40 million. Since the beginning of the program, the Ministry had reduced the unfunded liability to just under $5 million in 2015 through the collection of security deposits, demonstrating the efficacy of the program. However, due to the prolonged downturn in the industry, the unfunded liability rose to approximately $23 million in 2016. This is attributable to a relatively small number of companies and is not indicative of an industry-wide inability to cope with program requirements. In the past fiscal year, the Ministry has been able to reduce the unfunded liability by $13.7 million to under $10 million.

The major risk the Ministry faces in cleaning up orphan wells and sites is ensuring the ability to respond in a timely manner when they occur. Often as sites become orphaned, they may have fallen into a state of disrepair and there may be environmental impacts. For example, a defunct company may not have been honouring lease agreements with affected landowners for several years causing distrust among some landowners who may take action to refuse or defer access to their land. Site clean-up and reclamation should occur in a timely fashion.

Figure 3

To date, 394 wells have been classified as orphaned under the program. Of these, 295 have been abandoned using the Oil and Gas Orphan Fund.

Program Activities

During the 2016-17 fiscal year, the Ministry invoiced $2 million in its annual orphan fund levy. The Ministry also carried out approximately $2.9 million in abandonment and reclamation projects. This included the abandonment of 76 orphan wells, 63 flowlines and various environmental site assessment and reclamation projects. The environmental projects included 116 Phase I Environmental Site Assessments, 75 Detailed Site Assessments, 6 Phase II Environmental Site Assessments, 24 reclamation projects and 23 applications for Acknowledgment of Reclamation (AOR).*

For the 2017-18 fiscal year, the Ministry is forecasting to complete approximately 60-70 orphan well abandonments and between 75 and 100 various site assessment and reclamation projects.

** Environmental and reclamation projects listed are at various stages of completion as these projects typically span over several years.*

Oil and Gas Orphan Fund
Financial Statements
For the Year Ended
March 31, 2017

PROVINCIAL AUDITOR
of Saskatchewan

INDEPENDENT AUDITOR'S REPORT

To: The Members of the Legislative Assembly of Saskatchewan

I have audited the accompanying financial statements of the Oil and Gas Orphan Fund, which comprise the statement of financial position as at March 31, 2017, and the statement of operations and accumulated surplus for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian public sector accounting standards for Treasury Board's approval, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of the Oil and Gas Orphan Fund as at March 31, 2017, and the results of its operations for the year then ended in accordance with Canadian public sector accounting standards

Judy Ferguson

Regina, Saskatchewan
July 18, 2017

Judy Ferguson, FCPA, FCA
Provincial Auditor

1500 Chateau Tower · 1920 Broad Street · Regina, Saskatchewan · S4P 3V2
t 306.787.6398 *f* 306.787.6383 *e* info@auditor.sk.ca
www.auditor.sk.ca

Statement 1

OIL AND GAS ORPHAN FUND
STATEMENT OF FINANCIAL POSITION
As at March 31

	2017	2016
FINANCIAL ASSETS		
Due from General Revenue Fund (Note 5)	$ 10,750,828	$ 11,280,174
Accounts Receivable	38,339	34,265
Interest Receivable	38,593	30,278
Total Financial Assets	10,827,760	11,344,717
LIABILITIES		
Accounts Payable	343,589	801,849
NET FINANCIAL ASSETS AND ACCUMULATED SURPLUS (Statement 2) (Note 3)	$ 10,484,171	$ 10,542,868

(See accompanying notes to the financial statements)

OIL AND GAS ORPHAN FUND
STATEMENT OF OPERATIONS AND ACCUMULATED SURPLUS
Period Ended March 31

	Budget	Actual	
	2017 (Note 7)	2017	2016
REVENUES:			
Levies (Note 6)	$2,505,000	$ 2,000,000	$ 2,000,000
License Application Fees (Note 6)	400,000	140,000	210,000
Forfeited Security Deposits (Note 6)	----	591,766	111,975
Interest (Note 5 & 6)	150,000	128,456	121,375
Total Revenues	3,055,000	2,860,222	2,443,350
EXPENSES:			
Abandonment and Reclamation	3,000,000	2,918,703	3,353,165
Administration Costs	55,000	216	14,508
Total Expenses	3,055,000	2,918,919	3,367,673
ANNUAL LOSS	$ ----	(58,697)	(924,323)
ACCUMULATED SURPLUS, BEGINNING OF YEAR		10,542,868	11,467,191
ACCUMULATED SURPLUS, END OF YEAR – to Statement 1		$ 10,484,171	$10,542,868

(See accompanying notes to the financial statements)

OIL AND GAS ORPHAN FUND
NOTES TO THE FINANCIAL STATEMENTS
March 31, 2017

1. Authority

The Oil and Gas Environmental Fund was established on May 17, 1989, pursuant to Section 18.2 of The Oil and Gas Conservation Regulations, 1985 (Regulations). The Oil and Gas Environmental Fund originated through a one-time assessment of $100 per well to a maximum of $20,000 per operator.

In June 2007, an amendment was made to the Oil and Gas Conservation Act (Act) that provided for the continuance of the existing Oil and Gas Environmental Fund as the Oil and Gas Orphan Fund (fund) (Order in Council #442/2007). The purpose of the fund is to address the issue of abandonment of wells, decommissioning of facilities, and clean-up of those wells and facilities where the obligations of the person responsible for carrying out those activities are not being met.

2. Significant Accounting Policies

Pursuant to Canadian public sector accounting standards, the fund is classified as a government component. These financial statements are prepared in accordance with Canadian public sector accounting standards. These financial statements do not present a statement of cash flows because this information is readily apparent from the statement of operations and accumulated surplus. In addition, the financial statements do not present a statement of changes in net financial assets as the fund does not hold any non-financial assets. The fund did not have any re-measurement gains and losses, therefore a statement of remeasurement gains and losses has not been provided.

a) The fund recognizes orphan fund license application fees as revenue when received with the accompanying first-time license application.

b) The fund recognizes orphan fund levies as revenue when the levies are assessed.

c) The fund recognizes forfeited security deposits as revenue when the Minister declares them forfeited to the Crown in the right of Saskatchewan (see Note 6).

d) The fund recognizes any unused forfeited security deposits as an expense when the Minister approves their return to the depositor.

e) Interest is recorded as revenue when earned.

f) These statements are prepared in conformity with Canadian public sector accounting standards. These standards require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates. Differences are reflected in current operations when identified.

3. Net Financial Assets

Under section 118 of the Regulations the net financial assets, together with any future recoveries of well site restoration costs, are available to provide for expenditures for the purposes of:

a) abandonment of wells, flowlines and facilities and restoration of those sites, as a result of disappearance or insolvency of the well owner or operator.

b) containment or clean-up of major environmental problems arising from oil and gas exploration, development, production or transportation operations.

c) to pay for technical, administrative, legal or other costs incurred in pursuing reimbursement for the costs mentioned in a) and b) from the person responsible for paying them.

d) to pay for a defunct working interest participant's share of abandonment and reclamations costs if those costs were incurred by a working interest participant of the defunct party.

4. Financial Instruments

The fund's financial instruments include Due from General Revenue Fund, accounts receivable, interest receivable and accounts payable. These are recorded at fair value. The carrying amount of these financial instruments approximates fair value due to their immediate or short-term maturity. The Fund is exposed to minimal credit risk from the potential non-payment of accounts receivable. These instruments have no interest rate risk, liquidity risk or market risk.

5. Related Party Transactions

Included in these financial statements are transactions with ministries and agencies related to the fund by virtue of common control or significant influence by the Government of Saskatchewan.

The fund's money is deposited in the cobbed account of the province's General Revenue Fund (GRF) as a short term investment strategy and the

fund receives interest quarterly. A cobbed account means the money remains in a separate bank account at all times and is fully under the fund's control. Participation in the cobbed arrangement means that the interest on the bank account comes from the GRF rather than from a financial institution. That interest is based on the government's 30 day average interest rate, which is calculated and paid by the Cash and Debt Management Branch in the Ministry of Finance. The fund received $128,456 in interest in 2016-17 (2016 - $121,375). The effective interest rate in the year was 0.54% (2016 - 0.60%).

The fund has not been charged with any administrative costs and no provision for such costs is reflected in these statements. These costs are borne by the Ministry of the Economy.

6. Fees, Levies and Security Deposits

Section 16 of the Regulations requires all first-time applicants for a well or upstream facility licensee to pay a one-time fee of $10,000 which is deposited into the fund.

In order to pay the costs to abandoned and reclaim orphaned liabilities, the Saskatchewan Orphan Fund Levy was established. Each licensee in the province is levied, in accordance with the Regulations, on an annual basis to pay a percentage of a budget to carry out an annual orphan abandonment and reclamation program. Section 119 of the Regulations provides the details of how the levy is calculated for each licensee.

In addition, under the Licensee Liability Rating Program, the Minister in accordance with the Act and Regulations may require security deposits from holders of oil and gas licenses for the purpose of ensuring that they can meet their obligations with respect to suspension, abandonment, restoration, remediation, or reclamation of wells and upstream facilities and sites.

The security deposits are held on behalf of holders of oil and gas licenses, they are not included in the financial statements of the fund. At March 31, 2017, the fund held security deposits from the holders of oil and gas licenses consisting of $71,687,084 (2016 - $37,066,756) in irrevocable letters of credit and the Province's GRF held $19,221,174 (2016 - $8,126,218) in cash on behalf of licensees.

As a licensee's liability rating improves, the cash may be refunded to the licensee. The licensees were notified in writing that interest will not be calculated or paid on security deposits.

If the criteria of the Acts and Regulations are not met, the security deposits may be forfeited fully, or partially, and deposited into the fund.

7. Budget

The budget for the fund is included with the Ministry of the Economy budget submission to Treasury Board. Treasury Board approves the fund's budget annually.

8. Accounting Standard Changes

Accounting standard amendments which may impact the fund are not yet effective for the year ended March 31, 2017, and have not been applied in preparing these financial statements. In particular, the following accounting standard amendments are effective for financial statements on or after April 1, 2017:

PS 2200 - Related Party Disclosures
PS 3210 - Assets
PS 3320 - Contingent Assets

The extent of the impact on adoption of these accounting standards are not known at this time.